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No. 84-1274

In the Supreme Court of the United States

OCTOBER TERM, 1985

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, PETITIONER

v.

DIMENSION FINANCIAL CORPORATION, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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REPLY BRIEF FOR THE PETITIONER

I. INTRODUCTION

The question in this case is whether the Board acted reasonably when, after extensive rule-making proceedings, it promulgated an amended regulation defining two undefined terms in the Bank Holding Company Act: "deposits that the depositor has a legal right to withdraw on demand" and "commercial loans."

The Board acted within its discretion under the Act in defining these terms to include NOW checking accounts and money market instruments because its definitions comport with the ordinary meaning of the statutory language and with the legislative history, which shows that Congress intended the definition of "bank" to cover any institution that performs essential commercial banking functions, *i.e.*, offering checking accounts and making short-term extensions of credit in any form to business firms.

The Board's interpretation of these terms was in response to the recent development of so-called "nonbank banks"—banks, both national and state, which seek to escape coverage under the Act through a narrow and technical reading of these terms, while offering essentially the entire range of commercial banking services. The Board's definitions give full meaning to the statutory terms in order to minimize the use of the nonbank bank device to evade the Act, based on the Board's determination that a proliferation of nonbank banks would virtually nullify the Act's fundamental purposes of separating banking from commerce and assuring local control over banking structure.

Respondents' challenge to the Board's interpretations depends on reading into the statutory language limitations not evident on the face of the statute and on the completely erroneous view that the legislative history evinces an intent to create enormous loopholes in the Act's literal coverage. Respondents also ignore the fact that

Congress conferred on the Board special authority in the broadest possible terms to "issue such orders and regulations as may be necessary to enable it to administer and carry out the purposes of this Act and to prevent evasions thereof" (12 U.S.C. 1844(b))—an explicit grant to the Board of authority to forestall evasions of the Act of the kind advocated by respondents.

Before responding in detail to the arguments that have been advanced to curtail the Board's rule-making authority under the Act, we briefly summarize the principal points of disagreement.

a. The main argument advanced by respondents and the Acting Solicitor General is that even though the Board has expansive rule-making power, which includes power to prevent "evasions" of the "purposes" of the Act, the Board's regulation must nonetheless be set aside because it constitutes administrative revision of the Act. This argument is easily put to rest. There should be no serious question that NOW accounts, embraced within the Board's regulation, are "deposits that the depositor has a legal right to withdraw on demand." As the Board explained in *First Bancorporation* (J.A. 60a), even though an institution reserves the option to require prior notice from depositors, "until the institution invokes the notice requirement, the depositor has a right to withdraw funds on demand." Beyond this, the likelihood of a call for notice is entirely theoretical. No institution ever has required—or likely ever will require—prior notification of withdrawal with respect to a NOW account in view of the destructive consequences to the institution. In these circumstances, the Board respected both economic reality and the literal language of the Act when it ruled that the "legal right to withdraw" language includes NOW accounts.

The Board was equally faithful to the literal language of the Act when it defined the term "commercial loans." Under the ordinary meaning of the words used by Congress, commercial loans encompass loans "to supply the

credit needs of business enterprises * * * whatever form they take." H. Crosse and G. Hempel, *Management Policies for Commercial Banks* 192 (3d ed. 1980). The instruments included in the Board's definition each represent an extension of credit to a business—whether it be a bank or other business—for commercial purposes (Pet. App. 49a-59a). As the Board explained, "these [transactions] as a matter of law establish a debtor-creditor relationship and constitute an extension of credit or loan. Since these loans result in the provision of funds to commercial enterprises * * * and since they are not made for personal, family, household or charitable purposes, these loans are commercial loans for purposes of the bank definition of the Act" (Pet. App. 46a). Nothing on the face of the statute or in the common understanding of the language used by Congress even suggests that commercial loans are restricted solely to face-to-face transactions, as respondents have urged.

b. The Board's definitions do not rest solely on the literal language of the Act. The legislative history confirms that Congress intended the "legal right to withdraw" language to bring within the coverage of the Act all institutions that "accept deposits payable on demand (checking accounts), the commonly accepted test of whether an institution is a commercial bank." S. Rep. 1179, 89th Cong., 2d Sess. 7 (1966). This formulation was meant to encompass long-established regulatory standards under which NOW accounts were treated as demand deposits because of their checking feature even though subject to the reservation of a notice of withdrawal requirement.

Likewise, when Congress excluded institutions not making "commercial loans" from the coverage of the Act, it admonished that the Board should interpret this exemption, like all other exemptions enacted at the same time, "as narrowly as possible in order that all bank holding companies which should be covered under the Act in order to protect the public interest will, in fact, be covered." Conf. Rep. 91-1747, 91st Cong., 2d Sess. 23

(1970). The Board complied with the unambiguous mandate expressed in the legislative history when it rejected a narrow construction of the term "commercial loans" that would have allowed widespread corporate ownership of banks outside of the framework of the Act.

Stripped of excess verbiage, respondents' contention concerning the legislative history boils down to the claim that Congress intended to enact broad exceptions from the Act for large classes of institutions, regardless of their activities. Such a contention is plainly erroneous. The definition of bank prescribed in the original legislation covered virtually any bank-like institution. The 1966 amendment adding the demand deposit test was meant to exempt only limited purpose institutions that at the time performed none of the essential functions of a commercial bank. And, in 1970, when Congress broadly expanded the Act to cover one-bank holding companies, it incorporated the commercial lending test as a narrow exception to deal with "special cases" requiring "special treatment." Conf. Rep. 91-1747, *supra*, at 12, 23 (statement of House managers).

c. While respondents and the Acting Solicitor General have been quick to suggest their own definitions of the statutory terms, they have not even attempted to explain how their interpretations comport with the underlying purposes of the Act. When Congress passed the Act, it sought to prevent the "combination under single control of both banking and nonbanking enterprises." S. Rep. 1095, 84th Cong., 1st Sess. 2 (1955). It also sought "to retain local, community-based control over banking." *Northeast Bancorp* v. *Board of Governors*, No. 84-363 (June 10, 1985) slip op. 12. Both of these purposes would be entirely subverted if respondents' construction were accepted.

As the Board explained (Pet. App. 27a-31a), failure to give full scope to the statutory terms here at issue would permit an almost unlimited intermingling of banking and nonbanking business. That failure also would

permit bank holding companies to establish nationwide networks of institutions having essentially all of the characteristics of full-service commercial banks in contravention of the Act and the policies of a large number of states that oppose out-of-state entry (Pet. App. 31a).

To be sure, recent widespread attempts to exploit the commercial loan test in the Act's bank definition required the Board to reconsider past rulings regarding commercial loans. But the Board acted reasonably and properly in revisiting those rulings. It conducted a comprehensive rulemaking proceeding on all aspects of the issue and specifically identified those changes in economic conditions that compelled reconsideration. In its forty-page statement, the Board explained the reasons for reconsideration, noting that the past commercial loan rulings were not mandated by statutory language, were limited to the unique facts involved, and should not be expanded beyond those limited circumstances to permit widespread evasion of the Act. The Board's action thus falls squarely within this Court's holding that an agency "faced with new developments, or in light of reconsideration of the relevant facts and its mandate, may alter its past interpretation and overturn past administrative rulings and practice." *American Trucking Assn.* v. *Atchison, Topeka & Santa Fe Ry. Co.*, 387 U.S. 397, 416 (1967).

d. The crabbed reading of the Act urged by respondents would sap the Board's rule-making authority of necessary flexibility and open the door to serious evasions of the Act. Under respondents' interpretation, a company could evade the Act simply by causing its subsidiary bank to insert in its demand deposit contracts a theoretical and never-to-be-exercised right to require 24 hours, or even 10 minutes, advance notice. This notice provision would not affect the bank's ability to conduct all of the activities of a full-service commercial bank. Congress obviously intended the Board to have latitude to deal with such circumventions when it gave the Board

express authority to prevent "evasions" of the Act and its purposes.

In *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 365, 369-374 (1973), Chief Justice Burger, speaking for the Court, pointed out that an authorization to prevent "evasion" reflects Congress' concern that regulated entities "would attempt to characterize their transactions so as to fall one step outside whatever boundary Congress attempted to establish." This reality necessitates "regulation of subject matter not specifically mentioned in the enabling legislation." *Id.* at 365, 374.

This principle applies *a fortiori* in the present case because the Board's regulation encompasses subject matter that is specifically mentioned in the statutory language and legislative history.

e. At bottom, respondents and the Department of Justice disagree with the Board on a question of regulatory policy. But in advancing this position, they ignore the fact that Congress has delegated responsibility for administration of the Act exclusively to the Board, an independent administrative agency that is expert in banking affairs and most familiar with the history and purposes of the Act. When implementing the policies of the Act, "the Board's jurisdiction is paramount." *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 250 (1978). The Acting Solicitor General professes adherence to plain meaning, but his position is best explained as an attempt to stimulate congressional action to permit commercial ownership of banks and interstate banking by *de facto* actions that accomplish the same objectives through widespread chartering of nonbank banks. But these policy views cannot displace the reasoned decision of the Board. See *Bob Jones University* v. *United States*, 461 U.S. 574, 596 (1983). Accordingly, in this case, as in *Bob Jones*, this Court should reject the arguments of the Acting Solicitor General and sustain the regulation of the administrative agency.

II. THE BOARD'S DETERMINATION THAT NOW ACCOUNTS ARE DEMAND DEPOSITS FOR PURPOSES OF THE ACT IS CONSISTENT WITH THE LITERAL LANGUAGE AND LEGISLATIVE HISTORY OF THE ACT AND IS NECESSARY TO PREVENT EVASIONS OF ITS PURPOSES

A. Contrary to respondents' contention (AFSA Br. 13-18; SG Br. 11-12), the Board's finding that NOW accounts are demand deposits for purposes of the BHC Act is based upon the literal terms of the Act and not solely upon the functional equivalence of the two accounts. Respondents argue that NOW accounts are not "deposits that the depositor has a legal right to withdraw on demand" because they are subject to a right of the depository institution to require advance notice of withdrawal. It is undisputed, however, that in the absence of a depository institution's requirement of advance notice, a NOW account depositor has a legal right to withdraw funds on demand and the institution *is* legally obligated to pay the NOW account depositor on demand.

In theory, a depositor's legal right to withdraw from NOW accounts on demand could be terminated by a call for prior notice (Pet. Br. 31-33). This right to require prior notice, however, does not alter the fact that unless and until the notice is required, the depositor has a clear and judicially enforceable legal right to insist upon payment of funds on demand. Moreover, the likelihood of a call for prior notice on a NOW account is entirely theoretical. No depository institution ever has required notice, or is ever likely to do so, in view of the devastating effect such action would have on the institution's viability. Contrary to respondents' suggestion (AFSA Br. 15-16), depository institutions may not require notice selectively for an individual account, but must do so for *all* similar accounts (Pet. Br. 32 n.30).

Respondents attempt to portray this analysis as a "*post hoc* concoction of Board counsel" (AFSA Br. 15). But it was the Board, and not counsel, that expressly

found, in the *First Bancorporation* case (J.A. 60a), that "until the institution invokes the notice requirement, the depositor has a right to withdraw funds on demand."

Respondents and the Department of Justice seek to escape the literal meaning of the statute by arguing that, under the Board's reading of the statute, a passbook savings account would be covered as a demand deposit, a result that is in conflict with the legislative history (AFSA Br. 16 n.10; SG Br. 11 n.6). But the Board's analysis does not lead to this result. As discussed in detail below, the legislative history shows that the "legal right to withdraw" language, however broad and inclusive, was meant—in accordance with long-established and widely understood rules in effect at the time—to encompass demand checking accounts and to exclude savings accounts, such as passbook accounts, that do not have checking characteristics.

Respondents' interpretation not only clashes with the literal language of the Act, but also produces unreasonable results that would "defeat the plain purpose of the statute." See *Bob Jones University* v. *United States*, 461 U.S. at 586. Under respondents' construction, the reservation of *any* right to require notice of withdrawal—even if only for a few hours—would mean the depositor no longer has a "legal right to withdraw on demand." As a result, any commercial bank in the country could avoid coverage under the Act—without any meaningful alteration whatsoever in its banking operations—simply by inserting in its deposit contract a never-to-be-exercised right to require some notice of withdrawal. Congress did not intend the fundamental policies of the Act to depend upon such a technicality, and such a result is "plainly at variance with the policy of the legislation as a whole." *Wilshire Oil Co.* v. *Board of Governors*, 668 F.2d 732, 736-37 (3d Cir. 1981), cert. denied, 457 U.S. 1132 (1982). It is no exaggeration to say that if respondents' construction of the Act were accepted, the Act could easily become a dead letter.

B. The legislative history refutes respondents' contention that the demand deposit test was meant to exclude any deposit subject to a theoretical notice of withdrawal requirement (see Pet. Br. 26-31). The "legal right to withdraw" language was based upon, and was intended by Congress to incorporate, the distinction between demand deposits and savings accounts embedded in longstanding regulatory provisions in effect at the time (see Pet. Br. 30-31). Under these provisions, *any* deposit that could freely be drawn against by check, like a NOW account, was defined as "payable on demand," even though it was subject to a notice of withdrawal requirement. 12 C.F.R. 217.1(a), (e) (1963 and 1966 Supp.).

Thus, *at the time* the demand deposit test was added to the Act, the ability to withdraw by check, not the presence of a notice of withdrawal provision, was the decisive factor in distinguishing demand deposits (deposits payable on demand) from other types of deposits, including passbook savings accounts. This ruling had been in effect since 1935 and embodied the common understanding at the relevant time of the status of NOW accounts as demand deposits—not savings accounts. The payable on demand language, which reflected this distinction, was proposed by the Board to achieve the congressional purpose to exclude industrial banks that did not accept checking accounts of any kind, while continuing to cover commercial banks, the only institutions offering checking accounts at that time.

That Congress intended the "legal right to withdraw" language to incorporate this existing regulatory distinction is demonstrated by the fact that, in describing the statutory language, Congress equated it with the "payable on demand" language contained in the existing Board rule, and clearly stated that the language covered "checking accounts:"

> "the bill redefines 'bank' as an institution that accepts deposits payable on demand (checking ac-

counts), the commonly accepted test of whether an institution is a commercial bank * * *."

S. Rep. 1179, 89th Cong., 2d Sess. 7, 14 (1966); accord 112 Cong. Rec. 12385-86 (1966) (remarks of Sen. Robertson). In addition to this specific evidence of congressional awareness of the Board's rule, this Court traditionally presumes that Congress is aware of existing regulatory provisions when enacting statutes in the same field. See *Merrill Lynch, Pierce, Fenner & Smith* v. *Curran*, 456 U.S. 353, 379-381 (1982).

The fact that the Senate Committee Report expressly equated the statutory "legal right to withdraw" language with the proposed "payable on demand" language also demonstrates respondents' error in attributing significance to the Committee's replacement of the originally proposed terminology with the formulation actually enacted (AFSA Br. 17-18, 20; SG Br. 15 n.11). Clearly, the Act's drafters viewed these terms as interchangeable.

Respondents also argue (AFSA Br. 18-20, 22-23) that enactment of the demand deposit test in 1966 was intended to overrule a 1963 Board interpretation treating as "banks" industrial banks offering deposits that in actual practice are repaid on demand. But the error in respondents' analysis is evident. The Board's 1963 ruling by its terms plainly included institutions that offered *either* of *two* separate types of deposits: "deposits subject to check" or deposits that otherwise were in "actual practice repaid on demand" (savings accounts) (See Pet. Br. 28).

As we have shown above, the legislative history unmistakably demonstrates that Congress meant the demand deposit test to cover deposits subject to check, the first type of deposit described in the 1963 Board's ruling, and to reject only the second part of the ruling that covered institutions offering *non-checking* deposits that are repaid in practice on demand, *i.e.*, passbook savings accounts. Indeed, the industrial banking trade association that sought the demand deposit amendment testified

that industrial banks did not offer checking accounts and opposed *only* the second half of the Board's ruling, which covered institutions offering non-checking accounts:

> "The [Association], representing the companies affected, believe[s] that the *latter part* of the interpretation is improper, not within the spirit of the Act, and contrary to the intent of Congress." [1]

Thus, the association recognized that an industrial bank offering checking accounts should be covered under the Act—precisely the result achieved by the Board's regulation challenged here.

Respondents' assertion that Congress was not concerned with the nature of the instrument of withdrawal (*i.e.*, the check) (AFSA Br. 23) is refuted by the fact that every time Congress referred to the new "legal right to withdraw" language, it equated it with checking accounts (Pet. Br. 29-30). Indeed, Congress conspicuously inserted in its caption of the discussion of the new language the definitive term "checking accounts." S. Rep. 1179, *supra*, at 7.

C. Respondents' contention (AFSA Br. 21-22) that Congress intended the demand deposit test to exclude all industrial banks, regardless of their actual activities, is devoid of merit. The plain language of Section 2(c) makes clear that the services actually provided by an institution determine its status under the Act—not merely its charter. Indeed, in 1966, Congress replaced a charter test with the functional demand deposit test.

Industrial banks were excluded by the 1966 demand deposit amendment only because those institutions did not offer demand checking accounts, not because they were chartered as industrial banks. *1966 Hearings*, *supra*, at 157-158 (industrial banks only make loans to consumers and "do not accept checking accounts"). As

[1] *Hearings on S. 2353, S. 2418, and H.R. 7371 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 89th Cong., 2d Sess. 155, 157 (1966) (*1966 Hearings*) (testimony of Max A. Denney) (emphasis added).

the Board noted (Pet. App. 24a), recent legislative changes in several states have permitted industrial banks to provide both commercial loans and checking accounts, the characteristic functions of commercial banks. Institutions that exercise these powers and perform the functions of a commercial bank fall squarely within the intended ambit of the statute, regardless of the names or titles which are given to them. To the extent they are affiliated with an industrial or commercial firm, they are susceptible to the very abuses that the Act was designed to prevent.

Respondents also argue that the Board's definitions upset settled industry expectations and sweep industrial banks as a class within the coverage of the Act. There is no substance to either point. Contrary to respondents' reference to "hundreds" of covered institutions (AFSA Br. 2), only a small minority of the nation's industrial banks—approximately 53—offer NOW accounts and some of these would not be affected because they are not owned by companies.[2] The overwhelming majority of industrial banks continue to exercise only the traditional functions of those institutions—accepting savings deposits and making consumer loans—and thus are not banks under the Board's regulation. For example, in Colorado, where by far the greatest number of affected industrial banks are located, only 26 of 141 industrial banks accept NOW accounts, and NOW accounts represent less than one percent of the total assets of all industrial banks in the State. Colorado State Bank Commissioner, Seventy-fifth Annual Report 211-352 (1984). None of the industrial banks controlled by respondent Household Finance Corporation in Colorado currently offers NOW accounts (*ibid.*).

D. Respondents' reliance on several legislative and regulatory developments, each occurring after the 1966

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[2] *Hearings on S. 2181 and S. 2134 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 98th Cong., 2d Sess. 1643 (1984) (Part III) (Appendix B to testimony of Board Chairman Volcker).

Amendments (AFSA Br. 16-18, 28-35), is completely misplaced. Interpretation of the BHC Act must be based on its language and legislative history, not on subsequent developments. See *Consumer Product Safety Commission* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 117 (1980). And none of these subsequent developments—most of which are unrelated to the BHC Act—even remotely undermines the reasonableness of the Board's determination that NOW accounts must be treated as demand deposits to effectuate the purposes of the Act.

Contrary to respondents' assertions (AFSA Br. 11, 16-17; SG Br. 7, 14), the Board has *never* ruled, either before 1966 or thereafter, that NOW accounts are not demand deposits for purposes of the BHC Act. In March 1982, in its *First Bancorporation* decision (J.A. 59A-64A), the first case that raised the issue after NOW accounts were authorized on a nationwide basis in December 1980, the Board ruled that NOW accounts must be treated as demand deposits under the Act. It is true that the Board previously declined to treat as "banks" a handful of unique institutions chartered under New Hampshire law as guaranty savings banks (see AFSA Br. 16-17; SG Br. 14). The Board's decision, however, did not rest on a finding that NOW accounts are not demand deposits. Instead, the Board found that—unlike many of the industrial bank respondents here—the guaranty savings banks did *not* engage in the full range of commercial lending functions, but concentrated their lending in the residential mortgage area, like traditional savings and loan associations. *First NH Banks, Inc.*, 69 Fed. Res. Bull. 874, 875 (1983).

It is true, as respondents point out, that in authorizing NOW accounts on a nationwide basis in 1980, Congress noted that NOW accounts are subject to a notice of withdrawal requirement (AFSA Br. 29-30; SG Br. 13, n.8). But Congress also plainly recognized at the same time that NOW accounts are functionally equivalent to conventional demand deposits and must be regulated as

such in order to forestall evasion of legal requirements relating to demand deposits. S. Rep. 96-368, 96th Cong., 1st Sess. 5 (1979) (NOW accounts "are the functional equivalent of interest bearing checking accounts"); Pet. Br. 35-36.

The fact that NOW accounts are currently denominated as savings deposits under interest rate limitation and reserve requirement regulations (AFSA Br. 31-34) is not relevant. The decisive fact is that, at the time Congress adopted the demand deposit test, NOW accounts were defined as, and widely understood to be, demand deposits. Moreover, NOW accounts currently are classified as savings deposits for reserve requirement purposes in name only. They are treated as the equivalent of demand deposits pursuant to express congressional direction (Pet. Br. 36-37). The current classification of NOW accounts under interest rate limitation regulations simply provides a convenient method to specify the maximum interest rate to be paid on these accounts. The crucial fact is that Congress considered NOW accounts as demand deposits and authorized them *only* as an exception to the general federal prohibition on the payment of interest on demand deposits (*id.*, 35-36).

E. Respondents attack the Board's finding that NOW accounts must be treated as demand deposits in order to prevent evasions of the Act. They cite the self-evident proposition that the exercise of delegated power to prevent evasions of a statute may not reach conduct Congress did not intend to cover (AFSA Br. 26; SG. Br. 26 n.25). But the broad power Congress has granted the Board to prevent evasions of the Act reaches the obvious circumvention of the purposes of the Act involved here. This Court has recognized that an agency may exercise its authority to prevent evasions of a statute to reach even "matters not specifically mentioned in the enabling legislation," where necessary to prevent the statute from being frustrated. *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 374 (1973); *see Gemsco, Inc.* v. *Walling*, 324 U.S. 244, 255 (1945).

In 1966, Congress could not have foreseen the extent to which the subsequent authorization of NOW accounts would undermine the Act's objectives. Congress intended the Board to have flexibility to adapt regulatory requirements to evolving technological developments in the financial services industry. See *United States* v. *Southwestern Cable Co.*, 392 U.S. 157, 172 (1968).

In the context here at issue, the need for resolving doubts in favor of statutory coverage to effectuate congressional intent has explicitly been recognized in a well-reasoned opinion of the Third Circuit holding that a bank may not escape coverage under the Act simply by converting its demand deposits into notice-of-withdrawal checking accounts. *Wilshire Oil Co., supra.* The rationale of the *Wilshire* decision is applicable to NOW accounts whether or not they are offered to corporate depositors. In amending the Act to cover all institutions that offer "checking accounts" (S. Rep. 1179, *supra*, at 7), Congress made no distinction regarding the type of depositor holding such accounts. There is good reason for this: just like funds from corporate accounts, funds made available to an institution through NOW accounts can be used to engage in the kinds of discriminatory credit practices that Congress meant to eliminate when it enacted the BHC Act.

III. THE BOARD'S DETERMINATION THAT EXTENSIONS OF CREDIT TO BUSINESSES THROUGH MONEY MARKET INSTRUMENTS CONSTITUTE COMMERCIAL LENDING IS CONSISTENT WITH THE LITERAL LANGUAGE AND LEGISLATIVE HISTORY OF THE ACT AND IS NECESSARY TO PREVENT EVASION OF ITS PURPOSES

A. There is absolutely no support in the "ordinary meaning" of the statutory language for respondents' assertion that a bank engaged in the business of extending short-term credit to commercial enterprises by purchasing money market instruments is not engaged in commercial lending (and thus is not a "bank" under the Act) because it does not engage in "direct negotiations"

with borrowers (Dimension Br. 16-17; SG Br. 16-17). Certainly, the bank definition in the Act by its terms nowhere requires direct negotiations as a prerequisite to being "engage[d] in the business of making commercial loans." Nor does anything in the usual meaning of the words employed in the statute even hint at such a restriction. To "make" ordinarily means to perform, do, or effect. See *Webster's New International Dictionary* 1485 (2d ed. 1959). A "loan" is simply a sum of money lent at interest. See *id.*, at 1447. A "commercial" loan is one related to business or trade. See *id.* at 538. It is therefore evident from the face of the statute that Congress selected broad and generic—not restrictive—terminology in defining the requisite type of lending activity covered by the Act.

Respondents are in error in suggesting that there is, or was at the time the commercial lending test was added to the Act, some clearly-defined usage in the banking industry that would exclude all extensions of credit to businesses except those involving face-to-face dealings. To the contrary, the general understanding of the term "commercial loans" in the banking industry—both at the time of the commercial lending amendment and now—encompasses any loan, in whatever form, made to supply the credit needs of a business concern:

> "the foremost obligation of a commercial bank is to supply the credit needs of business enterprises, including farm operations, in its community. Loans that accomplish this general purpose, *whatever form they take,* are essentially commercial loans."

H. Crosse and G. Hempel, *Management Policies for Commercial Banks* 192 (3d ed. 1980) (emphasis added); accord G. Munn & F. Garcia, *Encyclopedia of Banking and Finance* 522 (8th ed. 1983); *id.*, at 421 (6th ed. 1962); L. Davids, *Dictionary of Banking and Finance* 51 (1978).

Moreover, the boundaries of transactions understood to be commercial loans never have been delineated with precision. According to an authority cited by the Justice Department:

> "A precise definition of 'business loans' is difficult because of their heterogenous character. Historical data * * * are often not available on a consistent basis * * *. Even for the more recent period, business loans have been defined in various ways for different purposes."

American Bankers Association, *The Commercial Banking Industry* 121 (1962); accord, B. Beckhart, *Business Loans of American Commercial Banks* 3 (1959) (business loans are "difficult to define and even to identify in bank portfolios").

None of the authorities relied on by respondents and the Justice Department expressly states that face-to-face negotiations are an indispensable attribute of a commercial lending transaction. Moreover, the Justice Department errs in suggesting (Br. 18) that the Comptroller of the Currency and the FDIC criticized the Board's definition as inconsistent with accepted industry usage. As explained *infra*, these agencies' objections were premised primarily on policy grounds.

Finally, we note that even respondents cannot dispute that purchases of the money market instruments described in the Board's regulation fall within the scope of transactions encompassed by the ordinary meaning of this statutory language: extensions of credit to businesses for short-term working capital needs. See B. Beckhart, *supra*, at 3 (business loans may include "acceptances and commercial paper purchased in the open market, as well as promissory notes"). The fact that certain of these instruments involve extensions of credit to a bank does not make these instruments any less commercial loans within the meaning of the Act, since a bank clearly is a business enterprise.

B. Respondents' self-serving interpretation of "commercial loans" also runs afoul of the unqualified legislative directive in the statement of the House managers in the Conference Report that the commercial loan provision (and all other exemptions enacted at that time)

must be "interpret[ed] * * * as narrowly as possible in order that all bank holding companies which should be covered under the Act in order to protect the public interest will, in fact, be covered." Conf. Rep. 91-1747, 91st Cong., 2d Sess. 23 (1970). This directive to the Board demonstrates a congressional recognition that the "commercial loans" exemption is not a self-executing provision based on some clearly defined industry standard, as respondents claim, but is a provision that must be "interpreted" by the expert administrative agency in order to effectuate Congress' intent.

In addition, the House managers recognized that the commercial loan provision would "apply to a very small number of special cases that, it is felt, require special treatment" (*ibid.*). Contrary to respondents' assertion (Dimension Br. 19 n.17), the statement by the House conferees on the narrow scope of the commercial loan exemption constitutes an accurate reflection of legislative will. Disagreements among the conferees concerned other matters. 116 Cong. Rec. 41954 (1970) (remarks of Rep. Widnall); see *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 73 n.54 (1981).

Respondents' reliance (Dimension Br. 19-21) on the money market activities conducted by the Boston Safe Deposit and Trust Company, the one trust company expected to be affected by the commercial lending test, is misplaced. Respondents offer not the slightest evidence that Congress was aware of each of the various activities conducted by Boston Safe. Congress held no hearings and conducted no inquiry into Boston Safe's activities. The *only* representation made to Congress regarding Boston Safe's activities was that it was a fiduciary institution, primarily engaged in managing trusts. *1966 Hearings, supra,* at 732. Moreover, Congress acted in reliance on the Board's representation that the exemption for non-commercial lending institutions would be of limited scope, "possibly affecting only one institution" (see Pet. Br. 41). In such circumstances, respondents' *post hoc*

arguments about the functions of the institution that was the intended beneficiary of the exemption is no substitute for the ordinary meaning of the words Congress enacted and the congressional injunction that they be narrowly construed.

C. Nor is there any merit to the contention that the Act's purposes are consistent with respondents' restrictive reading of "commercial loans." The fact that the commercial lending test was adopted in 1970 with little legislative discussion and was uniformly understood to create no significant loophole in the Act demonstrates that the exemption was not intended to be a significant retreat from Congress' basic objectives. The Board's construction of the statutory language to include all extensions of credit to businesses, whether direct or indirect, is necessary to assure, as far as is consistent with the literal language of the statute, that all of the Act's purposes are fully carried out.

Even if, as respondents assert, the terms of money market instruments were relatively standardized and rates were dependent on market forces—which often is not the case—in times of credit shortage a nonbank bank controlled by a retail enterprise, for example, could use its funds to purchase commercial paper or bankers' acceptances of its affiliated retail business in order to finance its operations, while refusing to purchase similar obligations of non-affiliated competitors. As we have shown (Pet. Br. 19-20), Congress proscribed the combination of banking and unrelated business to forestall preferential and discriminatory practices in the granting of credit. *E.g.*, 12 U.S.C. 1971, 1972; S. Rep. 91-1084, 91st Cong., 2d Sess. 3 (1970) (1970 Senate Report) (quoting remarks of Board Chairman Martin) (when banking and nonbanking businesses are combined, credit will be more available to customers of affiliated firms than to customers of unaffiliated firms). Contrary to respondents' claim (Dimension Br. 17), the potential for discriminatory practices inherent in the purchase of

money market instruments exists when credit is extended to a bank as well as to other types of businesses.

Moreover, as we have demonstrated, the restrictive reading of "commercial loans" advanced by respondents would significantly undermine the goal of the Douglas Amendment to "retain local, community-based control over banking." See *Northeast Bancorp* v. *Board of Governors*, No. 84-363 (June 10, 1985), slip op. 12. Respondents' reading would permit the establishment of multistate networks of NOW checking account-commercial lending banks despite the vigorous opposition of a number of affected states. Dimension's response (Br. 43) that Congress did not mean the Act to apply to Dimension because it is not one of the "established banking giants" is clearly wrong because the Act expressly applies to both large and small banks and Congress specifically rejected an exemption for small banks (see Pet. Br. 42). Dimension's argument also misses the point because, under the logic of Dimension's own argument, the nation's largest banking organizations would be permitted to construct exactly the same kind of interstate banking network as Dimension proposes. Similarly, the fact the respondent-intervenor Household Finance Corporation and *amicus* Sears, Roebuck & Co., which are among the nation's largest business organizations and which have extensive networks of nonbanking affiliates, control only relatively small banks does not negate the potential for the discriminatory credit practices the Act was designed to prevent.

The fact that nonbank banks themselves are subject to regulation by bank supervisors (Dimension Br. 41) is of course immaterial. The BHC Act is an independent regulatory framework that reflects Congress' determination that *holding companies* and *affiliates* of banks must also be supervised in order to protect the nation's financial system (see Pet. Br. 22-24).

Amicus Sears, Roebuck & Co. errs in characterizing as a "fiction" Congress' repeatedly-declared policy of separating banking from commerce (Br. 3, 7-8). It is beyond dispute that the BHC Act "was intended to implement a congressional policy against control of banking and nonbanking enterprises by a single business entity." *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. 27, 46 (1980); accord, S. Rep. 1095, 84th Cong., 1st Sess. 2 (1955); 1970 Senate Report, *supra*, at 2 (the combination under single control of banking and nonbanking enterprises departs from the "established policy of separating banking from other commercial enterprises").

D. Contrary to respondents' contention (Dimension Br. 22-27), the Board provided a reasoned basis for not relying on several early administrative interpretations of limited applicability. As the Board explained (Pet. App. 59a), these early rulings establish the same broad test for "commercial loans" prescribed in the regulation at issue here. And the exceptions that they granted were by their own terms of limited applicability and pertained only to the special circumstances there at issue.

In its first ruling, rendered only shortly after passage of the Act, the Board stated that commercial loans encompass

> "all loans to a company or individual, secured or unsecured, other than a loan the proceeds of which are used to acquire property or services used by the borrower for his own personal, family, or household purposes, or for charitable purposes." [3]

This interpretation, which has remained the touchstone of the Board's application of the Act's commercial loan provision, was reaffirmed in the Board's June 1972 letter regarding Boston Safe's status under the Act. In that letter, the Board found that Boston Safe was "principally engaged in a trust business" (J.A. 93A) and concluded that "in the circumstances of this case" money market instruments, such as certificates of deposit, commercial paper, and bankers' acceptances, and the sale

[3] Letter, dated July 1, 1971, from the Board to Greater Providence Deposit Corp.

of federal funds would not be regarded as commercial loans (J.A. 94A).

Clearly, this ruling represents an *ad hoc* judgment based on the Board's enforcement discretion and its view that the purposes of the Act would not be impaired in the particular circumstances involved. The same limitations are inherent in the Board's ruling that certificates of deposit purchased by a subsidiary bank of Chrysler Corporation chartered for the sole purpose of collecting drafts drawn on car dealers were not commercial loans. This ruling was based on the unique circumstances involved—in particular, Chrysler's strained financial condition and the enactment of a federal statute designed to prevent Chrysler's failure.[4] Even in this special situation, however, the Board prohibited the purchase of commercial paper and bankers' acceptances. Finally, the Board's letter to Gulf and Western Corporation (J.A. 110A-112A), also relied on by respondents, made no mention of money market instruments.[5]

The Board's reconsideration of these early views included a formal rulemaking proceeding. After careful consideration of the record, the Board concluded that the earlier, restrictive reading of "commercial loans" is not required by the statutory language or history and, judged in light of current circumstances, fails to give effect to Congress' intent. The Board also found that these early rulings did not—and had no occasion to—consider the extent to which the Act would be evaded if the rulings were exploited by nonbanking companies as a means to acquire commercial banks whose only purpose in substituting money market instruments for other commercial loans was to enable their parent companies to escape

[4] [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 98770.

[5] The staff letters cited by respondents (J.A. 99A-105A) state a rationale for excluding certain loans based on the existence of face-to-face negotiations that never has been embraced by the Board and that has no basis in the statutory language.

the Act. In these circumstances, the Board acted reasonably in clarifying its past pronouncements and construing the Act in its contemporaneous economic context. See *Motor Vehicle Manufacturers Association* v. *State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 42 (1983) (agencies must be given "ample latitude to 'adapt their rules and policies to the demands of changing circumstances' ").

IV. THE BOARD'S VIEWS ON THE INTENT AND PURPOSES OF THE ACT ARE ENTITLED TO DEFERENCE

Respondents advance a variety of contentions to attack the well-founded principle that the Board's exercise of its broad power to administer and prevent evasion of the Act is entitled to judicial deference. Each of these assertions is unpersuasive.

A. The Justice Department's assertion that the Board's action somehow upsets the "delicate balance" among government regulatory agencies (Br. 2) misrepresents the regulatory framework established by Congress and distorts the effect of the Board's action. The administration of the BHC Act is a matter committed specifically and exclusively to the Board. See *Whitney National Bank* v. *Bank of New Orleans and Trust Co.*, 379 U.S. 411, 419 (1965); *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 250 (1978). Moreover, the Board's rule regulates the corporate owners of banks. The rule in no way infringes the regulatory responsibilities of the FDIC or the Office of the Comptroller of the Currency (OCC), which share responsibilities at the federal level with the Board for the supervision of *banks.*

Consequently, it is evident that the objection of these agencies to the Board's regulation is premised primarily on their belief that the reasons for Congress' adoption of the Act are no longer valid in light of current industry conditions. Indeed, the FDIC, while objecting to the Board's action on policy grounds, does not question the Board's authority to adopt the challenged regulation

under existing law (SG Br. 18). The OCC's analysis of the Act is plainly colored by that agency's oft-repeated view that, in light of recent marketplace developments, existing regulatory restrictions governing the banking industry must be significantly relaxed (*e.g.*, *Hearings on H.R. 5734 Before the House Comm. on Banking, Finance and Urban Affairs*, 98th Cong., 2d Sess. 1623-1633 (1984) (testimony of C.T. Conover)) and its statement that it would charter nonbank banks to stimulate congressional expansion of national bank powers. Statement by C.T. Conover, Comptroller of the Currency, News Release 84-42 (May 9, 1984). The OCC has subsequently chartered nonbank banks on a large scale, where the only purpose of the charter is to avoid either the restrictions on combining banking and commerce or interstate restrictions in the BHC Act (see Pet. Br. 24-25). Moreover, the Federal Home Loan Bank Board believes that the Board's definitions are within its "clear authority" under the Act and necessary to carry out its purposes. See Appendix, *infra*.

The Justice Department's decision to oppose a client agency can only be explained as an attempt to further the policy goals reflected in the OCC's statements. But it is the Board, an independent agency, to which Congress has delegated administration of the BHC Act. And it is the Board's view that should be accorded deference.

B. Respondents' assertion that the Board's definitions will cause a "dramatic change" in the current structure of the banking system (AFSA Br. 40; Dimension Br. 49, SG Br. 27-28) is totally without factual support. On the contrary, acceptance of respondents' and the Justice Department's position regarding the nonbank bank device would result in a fundamental and dramatic change in the structure of the banking system in the United States without congressional authorization or consideration of the underlying safety and soundness and other policy issues.

The Board's definitions do not upset settled practices of industrial banks (see pp. 11-12, *supra*). Moreover, the few companies affected need only cause their subsidiary industrial banks to cease offering NOW accounts or register as bank holding companies.

The impact of the Board's determination on savings and loan associations that are not federally insured is minimal. For all practical purposes, this class of institutions is no longer in existence, given the regulatory and industry reaction to panic withdrawals experienced by such institutions in Ohio and Maryland (Pet. Br. 23 n.16). State laws in Ohio and Maryland now require virtually all savings associations to obtain federal deposit insurance (*ibid.*). In North Carolina and Massachusetts, privately insured thrift institutions have obtained or have applied to obtain federal insurance.[6] In California and Pennsylvania, state authorities have strongly encouraged privately insured institutions to obtain federal insurance and in the remaining states, Kansas and Iowa, we have been advised that there are no privately insured institutions that currently offer NOW accounts.[7]

Finally, virtually all of the nonbank banks that are chartered as commercial banks but that voluntarily forego either offering demand deposits or making commercial loans to avoid status as banks under the Act, such as those formed by respondent Dimension, came into existence after 1982. Thus, they knew, or should have known, the effect that the Board's current construction of the bank definition would have on their operations.

C. Respondents also err in contending that the Board's determination usurps a legislative function (AFSA Br. 38-41; Dimension Br. 45-50; SG Br. 25-29). By its terms, the Board's action here is grounded squarely on factors within the Board's expertise as the administrator of the statute: an analysis of the language, history, and purpose of the Act as applied to specific financial trans-

[6] Pet. Br. 23 n.16; Am. Banker, Aug. 27, 1985, p. 3.

[7] 1985 Cal. Legis. Serv. 991-992 (West); Am. Banker, Aug. 23, 1985, p. 2.

actions, as well as the exercise of express authority delegated to the Board to prohibit "evasions" of the statute (Pet. App. 32a-61a). By contrast, if respondents' interpretation of the Act were adopted, the discretion of Congress to legislate would be severally impaired by a flood of newly created nonbank banks claiming a vested interest in the *status quo*. The overwhelming weight of current congressional opinion recognizes that the nonbank bank device is contrary to the fundamental policies of Congress and frustrates the operation of existing law. See, *e.g.*, H.R. Rep. 98-889, 98th Cong., 2d Sess. 9 (1984) (nonbank banks are "designed to avoid the impact of certain banking laws and make it impossible to enforce the spirit of those laws"); 130 Cong. Rec. S 13562 (daily ed. Oct. 4, 1984) (joint statement of Chairmen of Senate and House banking committees declaring that new nonbank banks will *not* be grandfathered by new legislation governing this subject).

The fact that Congress has not yet enacted new legislation dealing with nonbank banks has little probative value. Congress' failure to enact bills relating to an existing statute does not demonstrate "a congressional construction of the meaning of the statute;" and the "advocacy of [new] legislation by an administrative agency * * * is an unsure and unreliable, and not a highly desirable, guide to statutory construction." *American Trucking Assn.* v. *Atchison, Topeka & Santa Fe Ry. Co.*, 387 U.S. 397, 417-418 (1967). In addition, Congress may well be satisfied with present regulatory and judicial actions limiting nonbank banks. Finally, proposed legislation now before Congress would have a far greater effect on the industry (by applying the Act to *all* FDIC-insured banks regardless of their activities (see H.R. Rep. 98-889, *supra*, at 11)) than would the Board's limited administrative action.

* * *

The nation's financial system is a highly complex and technical one, influenced by a host of rapidly changing and interrelated economic factors and subject to potentially severe strains. Rather than regulating that system itself, Congress has committed governance of critical aspects of the system to an expert and independent agency accompanied by an expansive grant of authority to carry out the legislative purpose. When, as in the present case, the agency takes action that is designed to preserve the integrity of the regulatory framework and that accords with the will of Congress, as expressed in the statutory language and legislative history, that action should be upheld. As Justice Rutledge explained in *Board of Governors* v. *Agnew*, 329 U.S. 441, 450 (1947) (concurring opinion):

> "Not only because Congress has committed the system's operations to [the Board's] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all its phases, I think their judgment should be conclusive upon any matter which, like this one, is open to reasonable difference of opinion."

For the foregoing reasons and the reasons set forth in petitioner's opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

OCTOBER 1985

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I authorize the filing of this brief.

CHARLES FRIED
Acting Solicitor General

APPENDIX

FEDERAL HOME LOAN BANK BOARD

NORMAN H. RAIDEN
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Mr. Michael Bradfield
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Federal Reserve Board
20th and Constitution Ave., N.W.
Washington, D.C. 20551

Re: *Board of Governors v. Dimension Financial Corporation, et al.*, No. 84-1274 (U.S. Supreme Court)

Dear Mr. Bradfield:

The Bank Board would like to express its support for the position taken by the Board of Governors before the Supreme Court in the above-captioned case.

The Board of Governors has obtained Supreme Court review of the decision of the Court of Appeals for the Tenth Circuit, striking down the Board's rule interpreting the definition of a "bank" in the Bank Holding Company Act of 1956 ("BHCA"). 12 U.S.C. § 1841(c). That interpretation, at 12 C.F.R. § 225.2(a)(1), would have brought many "non-bank banks" into the scope of the BHCA and subjected the companies that control them to regulation by the Board of Governors as bank holding companies. The Bank Board agrees with the Board of Governors that it has clear authority to adopt this rule under section 5(b) of the BHCA, which charges the Board "with exclusive authority to administer the BHCA and to issue such orders or regulations as may be neces-

sary to enable it to carry out the purposes of the BHCA and to prevent evasions thereof." 12 U.S.C. § 1844(b).

The Bank Board shares the conviction of the Board of Governors that the current proliferation of "non-bank banks" constitutes a serious evasion of the comprehensive scheme of federal regulation of financial institutions. Such institutions operate as the functional equivalents of commercial banks wholly outside of the federal laws governing the operations of banks or savings and loan associations. The exploitation of this "loophole" has caused dramatic changes in the financial services industry with none of the stabilizing safeguards that historically have accompanied the passage of significant deregulatory legislation. Of particular concern to the Bank Board is the ability of these institutions to operate nationwide, notwithstanding Congressional policy strictly delimiting the interstate operation of commercial banks and thrift institutions set out in the BHCA and the Garn-St Germain Depository Institutions Act of 1982 ("the Garn Act").

Through this evasion of federal law, the growth of "non-bank banks" has in fact already seriously jeopardized the ability of the FSLIC to resolve problem cases through less costly interstate acquisitions. Section 123 of the Garn Act granted the Bank Board the enhanced authority to arrange interstate acquisitions of thrifts in supervisory cases, dramatically reducing the cost of these cases to the FSLIC. The ability of companies to operate financial institutions interstate as "non-bank banks," immune from federal regulations on interstate operation, has greatly lessened interest in thrift acquisitions by potential acquirers, frustrating the intent of Congress in the Garn Act to enable the FSLIC to utilize its limited interstate franchise powers to bolster the ailing FSLIC fund.

In striking down the rule, the Court of Appeals failed entirely to appreciate that non-bank banks in fact constitute a serious evasion of the BHCA, both as to interstate operation and mingling of banking and non-banking activities. The fact that the Board of Governors' previous interpretation of the BHCA permitted the development of these institutions does not, as the Court of Appeals concluded, indicate that the operation of non-bank banks cannot now constitute an evasion of the BHCA. That previous interpretation had repercussions on the financial services industry that the Board of Governors could not foresee. The Supreme Court has long recognized that federal agencies "must be given ample latitude to 'adapt their rules and policies to the demands of changing circumstances,' *Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968)." *Motor Vehicle Manufacturers Ass'n v. State Farm Automobile Insurance Co.*, 463 U.S. 29, 42 (1983). This flexibility is crucial for financial regulatory agencies, which must respond to a technological revolution in the financial services industry and the growth of competitive pressures that could not have been anticipated even a decade ago.

While the Bank Board has urged Congressional action on the non-bank bank issue, it strongly disagrees with the conclusion of the Court of Appeals that the Board is helpless to deal with an obvious "evasion" of the purposes of the BHCA until Congress acts. It is the responsibility of the Board of Governors and the other financial regulatory agencies to consider the entirely new issues raised by the growth of "non-bank banks" in interpreting federal banking law and in carrying out their statutory duties. In the view of the Bank Board, the challenged rule constituted a reasonable and reasoned interpretation of the BHCA, and a thoughtful, rational response to the "non-bank bank" problem. That interpretation accurately reflected the fact that "non-bank banks" provide services and make investments that are the functional equivalent of demand deposits and "commercial loans" and that appropriately should bring them within

the ambit of the BHCA. The Court of Appeals should have accorded this interpretation substantial deference, as a regulation issued pursuant to an express delegation of rulemaking authority by an expert administrative agency. *See Securities Industry Association v. Board of Governors*, No. 83-614, (June 28, 1984) slip op. 8.

In sum, the Bank Board fully supports the position of the Board of Governors before the Supreme Court in this case.

Very truly yours,

/s/ Norman H. Raiden
NORMAN H. RAIDEN
General Counsel